

# PSJ3

# Exhibit 590



## Internal Audit Report

**Date** February 18, 2014

**Subject** Internal Audit Review of AmerisourceBergen (ABC) Ordering, Receiving and Invoice Payment Processes

**From** Howard Greene, Project Manager – Internal Audit  
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**To** Michael Bleser – Divisional Vice President Pharmaceutical Inventory Optimization & Analytics  
Dan Doyle – Divisional Vice President and Finance Officer, Pharmacy Operations  
Matt Faulkner – Business Unit Controller  
Jeffrey Foreman – Divisional Vice President Rx Purchasing  
Rick Gates – Divisional Vice President Health and Wellness Initiatives, Community Management  
Sue Halliday – Divisional Vice President Accounting Shared Services  
Natasha Polster – Senior Director, Pharmacy Integrity and Third Party Operations

**Cc** K. Crawford, C. Domzalski, J. Dubinsky, R. Flanagan, T. Gorman, T. Heidloff, P. Kapoor, W. Miquelon, J. Koziel, M. Scholz, R. Swords, M. Wagner, [D. Pinon](#), [B. Schneider](#), [T. Sabatino](#)

### Conclusion

In our opinion, the internal controls over the ordering, receiving and invoice payment processes for pharmaceutical merchandise purchased from AmerisourceBergen for the US mainland and Hawaii retail stores need to be improved. These areas include:

- A. [PurchasingReceiving](#)
  - [Implement a chain-wide pharmacy receiving process](#)
  - [Enhance ABC Tote Security](#)
- B. [Ordering](#)
  - A. [Revise purchasing process](#) from the secondary supplier (Anda, Inc.)
- A. [Pharmacy receiving procedures](#)
- B. [Tote Security](#)
- C. [Invoice Payment Procedures](#)
  - B. [Improve](#) Invoice verification procedures.

Management is in the process of taking appropriate action to resolve the [exception\(s\)](#) exceptions noted above. See Attachment A for further details.

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### Background

As part of a strategic shift in supply chain, in 2013 Walgreens moved ordering and receiving of pharmaceutical merchandise away from corporate and the Distribution Centers (DCs) to individual store locations under the Direct Store Delivery (DSD) initiative. This strategic shift resulted in a switching of pharmaceutical wholesale supplier from Cardinal Health to AmerisourceBergen Corporation (ABC). The DSD initiative was deployed in phases beginning in 2013 and ongoing through 2014. The first and second

phases involving branded and controlled substances were implemented in calendar year 2013, while the third and final phase involving generics is currently under implementation beginning January 2014.

With the switch to ABC, pharmaceutical merchandise is now delivered directly by truck couriers to all 8,200 Walgreens store locations in the US mainland and Hawaii from ABC's Distribution Centers. There are approximately 25 ABC Distribution Centers located across the US mainland.

Walgreens operational business relationship with ABC is governed by the Pharmaceutical Purchase and Distribution Agreement (PPDA) that was executed in 2013, and annual purchases of pharmaceuticals from ABC are estimated to be \$30 Billion per year.

#### **Objective**

1. Obtain an understanding of US mainland and Hawaii ABC branded, generic and controlled substance (C2) pharmaceutical merchandise ordering, receiving, and invoice payment processes.
2. Perform a risk assessment to evaluate the design of internal controls in place to manage the ABC ordering, receiving, and invoice payment processes.

#### **Scope**

Internal Audit reviewed the ordering, receiving, and invoice payment processes established and currently in place for pharmaceutical merchandise purchased from ABC for the US mainland and Hawaii store locations. [This Internal Audit review consists solely of process owner interviews and observation of certain practices at select stores.](#)

The scope of this review did not include a review of the AmerisourceBergen contract (PPDA). Internal Audit [performed is in the process of performing](#) a separate review of the [ABC](#) PPDA.

Internal Audit procedures were performed during the period of September, 2013 through February, 2014

#### **Findings**

The audit identified opportunities for improving controls around the ordering, invoicing and receiving processes for pharmaceutical merchandise purchased from ABC. Findings and detailed recommendations along with Management responses are included in Attachment A.

We would like to thank Management for their assistance and cooperation during our review.

#### **A. Receiving**

##### **Background**

ABC deliveries of pharmaceutical merchandise to Walgreens retail stores in the US mainland and Hawaii occur five days a week (Monday-Friday) by 2:00pm. Deliveries are made by ABC hired truck couriers and are dropped off at the back door of the supply room at each Walgreens store location. An exception exists for deliveries in California where the truck courier delivers drugs through the front door directly to the store pharmacy. Pharmaceutical merchandise is delivered in sealed plastic totes.

Store Operations procedures require that the store employee verify that the number of plastic totes delivered to the store matches the number of plastic totes on the shipping manifest. The totes are then delivered to the pharmacy where they are checked into the store inventory system.

When checking in controlled drugs, the pharmacy staff is required to individually verify and check in all items against the ABC invoice and Drug Enforcement Agency (DEA) 222 forms. For non-controlled drugs, pharmacy staff have been directed to not check in each individual item, but only that the tote (as indicated in store SIMS) has been received (unless a tote has been selected for a tote audit).

Corporate management believes that checking in all non-controlled drugs at the item level as part of the ABC receiving process is impractical based on the limited staffing resources available in the retail stores, and the potential negative impact on customer service.

Beginning in September 2013, the Community Management Division (Store Operations) implemented a tote audit process which selected a judgmental sample of 1,000 retail stores for tote contents verification. The tote audit process required the selection and contents verification of one tote per week at each selected store. For each selected tote, the contents are to be 100% verified against the ABC invoice. The results of the tote contents verification process including any discrepancies are to be submitted by each selected store to Store Operations via a web based survey monkey questionnaire.

##### **Issues**

##### **(1) Pharmacy Receiving Procedures**

Pharmaceutical merchandise received from ABC is not physically verified and matched to the original purchase order or POA and ABC invoice prior to posting of the receipt in the store SIMS system. Walgreens is, therefore, relying on ABC's internal controls over order filling and shipping to ensure the accuracy of orders delivered to the retail stores.

Supporting documentation such as purchase orders or POAs and invoices for pharmaceutical merchandise received from ABC should be matched to items physically received to ensure that ABC delivered the correct quantities and types of merchandise, and that Walgreens is billed correctly. Historically, a three-way match process was utilized for merchandise delivered to Walgreens Distribution Centers.

##### **Risk**

If received items and quantities are not compared to the original purchase order or POA, there is the risk that unauthorized and/or erroneous changes to an order by ABC will not be detected in a timely manner. In addition, if an order is not properly filled by ABC, or product is missing or stolen in transit, the SIMS inventory system will be erroneously updated and subsequent auto-ordering of replenishment merchandise will be inaccurate. This could lead to out of stock conditions with a negative impact on customer service and Company revenue. Also, invoices received from ABC may

be incorrect and show quantities of merchandise that were not received resulting in potential overpayments for inventory.

#### Recommendations

- 1) The Community Management Division should design and implement a mandatory continuous tote audit process for all retail stores. The number of stores selected for the tote audits should either reflect a statistically valid sample of all Walgreens US mainland and Hawaii stores, or if judgmentally selected, should cover a significant number of all stores. The contents of totes selected in the sample should be inspected and checked in at the item level against invoices received from ABC. The results of the tote audit process should be monitored by Walgreens management to ensure that ABC is accurately invoicing Walgreens.
- 2) Walgreens should work with ABC to arrange for consider obtaining a periodic external independent audit review of ABC's internal controls over order filling, shipping, billing, etc. such as a SSAE 16 Review by an independent auditor. The results of these audits should be reported to Walgreens management.

#### Management's Response (Recommendation 1):

**Dan Doyle – Divisional Vice President and Finance Officer, Pharmacy Operations**  
**Mike Bleser – Divisional Vice President Pharmaceutical Analytics and Optimization**

Starting April 2014 a new tote audit process has been implemented chain wide. The tote audit process is not a statistical sample, but rather takes a coverage based approach to ensuring accuracy of the Rx inventory received at the store level. Under the new process each store across the chain will check in at the item level against invoices received from ABC one daily inventory receipt per week. In this manner approximately 15-20% coverage of all Rx inventory receipts will be achieved by the tote audit process. In addition, C2 inventory will continue to be checked in at a 100% rate, increasing the overall coverage percentage.

The detailed results of these tote audits will be compiled and analyzed by the Rx Inventory team under Mike Bleser's leadership. Exception resolution / follow up, to the extent required will also be owned by Rx Inventory. Evaluation of the overall effectiveness of the tote audit process and any potential adjustment in scope (expansion or reduction) will be performed by Pharmacy Finance under Dan Doyle's leadership after consulting with Accounting and Store Operations.

#### **Matt Faulkner – Controller**

Retail Accounting will use the results of the tote audits to determine if inventory is properly stated on the books. The data will help determine if an additional reserve will be required or if the Rx shrink reserve is adequate to cover any potential losses.

#### Management's Response (Recommendation 2)

#### **Jeffrey Foreman – Divisional Vice President Rx Purchasing**

A Walgreens and AmerisourceBergen meeting will take place in April, 2014. At that meeting, representatives have commenced discussions around the proposed recommendation for a SSAE16 review will be made to AmerisourceBergen for their consideration. Depending on the outcome of the meeting, we. These discussions are ongoing and if agreed upon, Walgreens will strive to make this (SSAE 16 review) a contractual amendment if necessary.

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Estimated Completion Date – ~~May 31~~October 30, 2014

**(2) Drug Enforcement Administration (DEA) Compliance**

Walgreen store policies and procedures related to the receipt of C2 merchandise require that the DEA 222 Form be used by the pharmacy to check in an order when it is received from a vendor. Each DEA 222 Form is comprised of 3 copies. Two copies are sent from the designated Walgreen DC to AmerisourceBergen when the order is made. Upon fulfillment of the order, one copy is sent to the DEA while the other copy is retained by AmerisourceBergen. In addition, a third copy (blue copy) of the DEA 222 form are sent to the stores. Since the supply chain conversion to ABC, the blue copies of the DEA 222 Form are sent by Walgreens Distribution Centers to the stores via overnight express mail. When Walgreens DCs previously delivered controlled drugs to stores, the 222 Forms were enclosed in totes delivered to the pharmacy.

Fiscal Year 2014 Financial & Compliance (store audits) conducted by the Walgreens Internal Audit Department have indicated that some stores are receiving and checking in C2 controlled drugs without a copy of the 222 form because it was not on hand at the time an order was received.

**Risk**

Walgreen stores are not in compliance with Walgreen internal policies and procedures for receiving C2 merchandise.

**Recommendation**

Until a time when the current manual DEA Form 222 process is replaced with the new electronic Controlled Drug Ordering System (CSOS), the Rx Inventory and Store Operations Departments should research and enhance the current manual process to ensure that the DEA 222 Forms are in the pharmacies when C2 drugs are received from ABC and checked in accordingly.

**Management's Response**

**Tasha Polster, Senior Director Pharmacy Integrity and Third Party Operations**

CSOS has been rolled out to 97% of all United States mainland and Hawaii retail stores as of April 2, 2014. There are 137 new U.S. mainland stores awaiting CSOS licensing by the Federal Drug Enforcement Administrations. In addition, CSOS has not yet been implemented in Puerto Rico (PR) due to local regulatory requirements. Walgreens Regulatory law is working with Government Affairs to approach the PR regulatory authorities in order to assess whether CSOS will be allowed in PR. A timeline for expected resolution is not currently available since the PR regulatory authorities are the primary drivers of any resolution.

For retail stores where CSOS has not yet been implemented, the overnight FedEx process for sending Form 222 to the stores should help ensure that the forms are present when C2 drugs are received and checked in by the pharmacies.

Estimated Completion Date (US Mainland & Hawaii) - October 31, 2014.

Estimated Completion Date (Puerto Rico) – ~~Rejected due to Puerto Rico~~October 31, 2014 (for status update on PR regulatory requirements approval process)

**(3) Policies and Procedures**

Policies and procedures issued by corporate management that clearly indicate to store and pharmacy personnel how ABC merchandise is to be received are an important internal control that helps to ensure that personnel in all 8,200 retail stores utilize consistent procedures. Policies and procedures that have been issued to date for retail store personnel related to the receiving process for ABC merchandise are vague and inconsistent.

For example, during the review, Internal Audit was advised by corporate RX Inventory and Community Operations management that store pharmacy personnel have been instructed not to check in all non-controlled drugs received from ABC at the item level. However, instructions to the stores for ABC receiving that were posted on Storenet indicated that store employees should check in all drugs received from ABC at the item level.

**Risk**

Lack of clear policies and procedures communicated to employees in the stores could result in inconsistent execution of key processes and noncompliance with management's directives.

**Recommendation**

Community management should develop and issue up-to-date, consistent, and clearly written policies and procedures to the stores related to receiving procedures for ABC merchandise. The issuance of policies and procedures should be reinforced with the provision of training to all impacted store personnel.

**Management's Response**

**Mike Bleser – Divisional Vice President Pharmaceutical Analytics and Optimization**

**Rick Gates – Divisional Vice President Health and Wellness Initiatives, Community**

**Management**

Corporate Rx Inventory will work with Community Management to develop an up-to-date procedural guide related to receiving of ABC merchandise by May 15, 2014. The guide will be issued as part of training for all impacted store personnel.

**Estimated Completion Date – May 15, 2014**

**(4) Tote Security**

Internal Audit visited Store #4067 in Buffalo Grove, IL on November 7, 2013 to observe the ABC delivery of drugs. During this observation it was noted that totes are not delivered by ABC in a physically secure manner. Each tote is delivered with a single plastic strap wrapped around it. The plastic strap does not adequately secure the tote as the tote lid can be raised high enough with the strap intact for a person to stick a hand in the tote and remove merchandise. Totes delivered to Walgreens retail stores should be physically secure to prevent unauthorized access to the contents of the totes.

**Risk**

Unsecured totes could result in theft of merchandise by ABC employees, ABC truck couriers, and/or Walgreens employees resulting in higher than acceptable inventory shrinkage.

**Recommendation**

Walgreens Rx Purchasing Department, with the assistance of Walgreens Loss Prevention should work with ABC to improve the way it secures totes at its Distribution Centers, to provide better physical security for the pharmaceutical merchandise delivered to Walgreens.

**Management's Response –**

**Jeffrey Foreman – Divisional Vice President Rx Purchasing**

A Walgreens and AmerisourceBergen meeting took place in April, 2014. Walgreens management discussed improvements needed to deal with the current security weaknesses associated with the method in which ABC secures Walgreens totes. ABC agreed with making changes to the security straps used on current totes subject to implementation costs. ABC is currently quantifying costs for changing to double straps on totes. A final resolution is pending.

**Estimated Completion Date – ~~May 31~~October 30, 2014**



**B. Ordering****Background**

Purchase orders for pharmaceutical merchandise are sent to ABC from retail stores in one of three ways:

- (1) Electronically through SIMS auto orders to replenish store inventory to predetermined target levels.
- (2) Via telephone calls to ABC's customer service center.
- (3) Through ABC's online Passport application.

In addition, the Corporate Rx Inventory Department occasionally issues chain-wide distribution purchase orders to ABC for drugs that are to be delivered to all retail stores.

When ABC receives a purchase order from Walgreens, ABC sends back an electronic Purchase Order Acknowledgement (POA) indicating if it can fill all or part of the order. If the POA indicates that all or part of an order can't be filled by ABC, store SIMS automatically generates another electronic purchase order which is sent to a secondary source supplier (Anda, Inc.).

**(H) Auto-ordering to Secondary Source**

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**Issue**

In our opinion, pharmaceutical merchandise orders should only be placed with the secondary supplier (Anda, Inc.) based on immediate need to fill a script. When SIMS receives a POA from ABC indicating that an order can't be filled in whole or part, an automatic purchase order is generated the same day and forwarded to the secondary supplier for fulfillment.

**Risk**

Items purchased from Anda incur a higher shipping cost on a per item basis (up to \$15 flat fee) regardless of the order quantity. Anda orders may also be supplied at a higher per unit cost than ABC leading to a higher than optimal ~~Cost~~cost of Goods Soldgoods sold for Walgreens.

**Recommendation**

Auto-orders to a secondary supplier should be delayed by the SIMS system until they are reviewed and approved by pharmacy Rx Inventory personnel to ensure that there is an immediate supply need for such merchandise. If the order can be delayed it may be possible to receive the merchandise from ABC upon product restocking at a reduced cost than if ordered through Anda.

**Management's Response:**

**Michael Bleser – Divisional Vice President Pharmaceutical Inventory Optimization & Analytics**

Walgreens is currently piloting a process in two districts which allow the store pharmacist to review and adjust the Anda order prior to submission. Only adjustments that reduce quantity or delete items in the order are permitted by the system. The new process is expected to be rolled out to all stores during April and May 2014.

**Estimated Completion Date – May 31, 2014**

### C. Invoice Payment Procedures

#### **Background**

ABC submits an electronic file of all invoices to Walgreens each month via EDI (Electronic Data Interchange) for Rx merchandise delivered to all of the retail stores. The Walgreens accounts payable department then pays the invoice by the contractual due date (24 days). In the following month the details of charges that were on the ABC invoice for each store are listed on the electronic store ledger for the respective store. The Automatic Ledger Reconciliation System (ALR) matches the amounts that were entered on the store's Buy Card Record System per invoice to the emailed ABC invoice on receipt date. Any identified discrepancies are to be worked to resolution by store management.

The Accounts Payable Department conducts a post-audit process to verify that the unit prices for Rx merchandise on the ABC invoice match the unit prices that have been provided by ABC for input into the ABC Price Catalogs maintained in a Walgreens mainframe computer system. Discrepancies between invoice and catalog prices are investigated by Accounts Payable and resolved with ABC.

#### **Issue**

##### **Invoice Verification**

The post audit process conducted by the Accounts Payable Department does not verify if the prices paid are correct in accordance with the terms of the PPDA, and thus does not function as an effective internal control over invoice cost accuracy. The audit only determines if two prices which are both provided by ABC match (ABC catalog price versus ABC invoice price).

##### **Risk**

ABC Invoices may be paid at prices that are not in accordance with the terms of the PPDA, which could result in increased cost of goods sold and a negative impact on cash flow.

##### **Recommendations**

- 1) The Accounts Payable Department should reconcile ABC invoice prices to the PPDA required prices (i.e., Wholesale Acquisition Cost (WAC) for branded drugs.)
- 2) To allow the Accounts Payable Department to verify invoices to the PPDA, The Pharmaceutical Inventory Optimization & Analytics Department should validate the ABC price catalog for branded drugs to an independent 3<sup>rd</sup> party source such as MedianMedispan for WAC pricing.

The results of the validation audits of ABC catalog prices for branded drugs to Medispan should be communicated by the Pharmaceutical Inventory Optimization and Analytics Department to the Shared Services Department.

#### **Management's Response**

##### **Sue Halliday – Divisional Vice President Accounting Shared Services**

The Shared Services Accounts Payable Department will obtain the results of the Pharmaceutical Inventory Optimization & Analytics Department verification of the ABC Catalog to Medispan and utilize them to validate the accuracy of invoices received from AmerisourceBergen.

**Michael Bleser – Divisional Vice President Pharmaceutical Inventory Optimization & Analytics**

Beginning in February 2014, the Rx Inventory Department implemented a monthly independent verification of the WAC prices provided by ABC for branded drugs in the price catalog to Medispan. The results of the verification will be communicated to the Shared Services Accounts Payable Department.

**Estimated Completion Date** - -- Completed